

**HIDDEN VALLEY LAKE
COMMUNITY SERVICES DISTRICT
CALIFORNIA**

**MANAGEMENT REPORT
FOR THE YEAR ENDED
JUNE 30, 2008**

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**HIDDEN VALLEY LAKE COMMUNITY SERVICES DISTRICT
MANAGEMENT REPORT
FOR THE YEAR ENDED JUNE 30, 2008**

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Board of Directors
Hidden Valley Lake Community Services District
Middletown, California

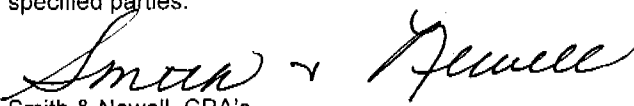
We have audited the financial statements of the business-type activities and each major fund of the Hidden Valley Lake Community Services District, Middletown, California (District), as of and for the year ended June 30, 2008, which collectively comprise the District's basic financial statements, and have issued our report thereon dated January 27, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Professional standards require that independent auditors communicate with the District about matters that are important to the District's oversight role. We previously reported on internal control and compliance in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards and in our Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance With OMB Circular A-133 dated January 27, 2009.

However, during our audit we became of certain other matters that are opportunities for strengthening internal controls and operating efficiency. The following report summarized all our comments and suggestions including immaterial noncompliance, control deficiencies that are not considered significant deficiencies or material weaknesses and other matters involving internal control.

We will review the status of these comments during our next audit engagement. We have already discussed these findings and recommendations with the District management, and we will be pleased to discuss them in further detail at your convenience.

This report is intended solely for the information and use of management, others within the organization, the Board of Directors and its regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.


Smith & Newell, CPA's
Yuba City, California
January 27, 2009

**HIDDEN VALLEY LAKE COMMUNITY SERVICES DISTRICT
MANAGEMENT REPORT
REQUIRED COMMUNICATION
FOR THE YEAR ENDED JUNE 30, 2008**

We have audited the financial statements of the business-type activities and each major fund of the Hidden Valley Lake Community Services District, for the year ended June 30, 2008, and have issued our report thereon dated January 27, 2009. Professional standards require that we provide you with the following information related to our audit.

1. Our Responsibilities Under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter, our responsibility as described by professional standards, is to express opinions about whether the financial statements prepared by management and Smith & Newell, CPAs with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered Hidden Valley Lake Community Services District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether Hidden Valley Lake Community Services District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also in accordance with OMB Circular A-133, we examined, on a test basis, evidence about Hidden Valley Lake Community Services District's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to each of its major federal programs for the purpose of expressing an opinion on Hidden Valley Lake Community Services District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Hidden Valley Lake Community Services District's compliance with those requirements.

2. Planned Scope and Timing of Audit

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters.

3. Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2007-2008. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements are depreciation of capital assets.

Management's estimate of depreciation is based on estimated or actual historical cost and the useful lives of such assets. We evaluated the key factors and assumptions used to develop depreciation estimates and determined that they are reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

**HIDDEN VALLEY LAKE COMMUNITY SERVICES DISTRICT
MANAGEMENT REPORT
REQUIRED COMMUNICATION
FOR THE YEAR ENDED JUNE 30, 2008**

4. Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

5. Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

6. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

7. Management Representations

We have requested certain representations from management that are included in the management representation letter.

8. Management Consultations with Other Independent Auditors

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

9. Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the District and management of the District and is not intended to be and should not be used by anyone other than these specified parties.

**HIDDEN VALLEY LAKE COMMUNITY SERVICES DISTRICT
MANAGEMENT REPORT
CURRENT YEAR COMMENTS - FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2008**

08-FS-01 STATEMENT ON AUDITING STANDARDS NO. 112

Condition

Currently, the District relies on the external auditors to ensure its financial statements are in accordance with generally accepted accounting principles (GAAP).

Cause

Prior to issuance of SAS 112, the District was able to rely on the external auditors to assist with the financial statements and related notes without being subject to control deficiencies.

Criteria

In May 2006, a new auditing standard, Statement on Auditing Standard No. 112, Communicating Internal Control Related Matters Identified in an Audit (SAS 112), was issued. The standard provides guidance in that if an entity is unable to draft its own financial statements, there may be a material weakness or significant deficiency. External auditors cannot be part of the District's internal controls, including controls over the preparation of the financial statements, and are prohibited from auditing their own work as doing so impairs their independence.

The District should have the capacity to prepare full disclosure financial statements in accordance with generally accepted accounting principles. To carry out this responsibility, the District must have proper internal controls over financial reporting in place. Proper internal controls over financial reporting include, but are not limited to, internal controls that identify misstatements in the financial records, retaining staff competent in financial reporting and related oversight roles, and adequate design of internal control over the preparation of the financial statements.

Effect of Condition

The risk of misstatement in the financial statements increases when management is not able to apply GAAP in recording the entity's financial transactions or preparing its financial statements, including the related notes. Also, by relying on the external auditors to ensure its financial statements are in accordance with GAAP, the District is considering the external auditors a part of its internal controls over the preparation of the financial statements.

Recommendation

The District may consider the following possible actions:

1. Provide training opportunities for its accounting staff that would enable them to become more familiar with the general disclosure requirements. This training should include, but is not limited to, the usage of a disclosure checklist, which provides guidance to the financial statement's content and whether a necessary disclosure has been overlooked.
2. Hire an external accountant to confirm that the financial statements and related disclosures are in accordance with GAAP.
3. Take no action. The District may find that the costs outweigh the benefits to adhere to this standard. No action will continue to result in a significant deficiency in the District's internal controls over the preparation of the financial statements.

Corrective Action Plan

The District is researching the possibility of hiring a regular part-time employee to adhere to this statement.

08-FS-02 CASH

Condition

At the time of our fieldwork, we noted that cash and investments held in the bank and LAIF had not been reconciled to the cash balance on the District general ledger for several months and there was a difference of \$172,000 in posting corrections.

**HIDDEN VALLEY LAKE COMMUNITY SERVICES DISTRICT
MANAGEMENT REPORT
CURRENT YEAR COMMENTS - FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2008**

08-FS-02 CASH (CONTINUED)

Cause

The District was not monitoring the cash balance on the general ledger.

Criteria

The risk of errors or irregularities occurring and not being detected timely is increased when the cash balance on the District general ledger is not reconciled to the cash held in the banks and Local Agency Investment Fund.

Effect of Condition

Cash was misstated on the District's books for several months by approximately \$172,000.

Recommendation

We recommend that cash be reconciled in a timely manner.

Corrective Action Plan

The money market, checking account and LAIF account are being reconciled on a monthly basis to ensure accuracy of the cash balance.

08-FS-03 CAPITAL ASSETS

Condition

At the time of our fieldwork we noted that the District had implemented a new software system to produce depreciation schedules for the District's capital assets. Previously, the District had used manual depreciation schedules. However, in the process of the conversion, the capital assets on the new software system were not reconciled to the capital assets as recorded on the old manual depreciation schedules or as recorded on the District's general ledger.

Cause

The District did not adequately review or monitor the conversion from the manual schedules to the software system for capital asset depreciation schedules.

Criteria

The depreciation schedules which account for the capital assets, accumulated depreciation and current year depreciation expense must be adequately reviewed to ensure accuracy.

Effect of Condition

The new depreciation schedules did not correctly reflect the investment in capital assets, the accumulated depreciation or the current year depreciation expense.

Recommendation

We recommend that the District review and monitor the depreciation schedules to ensure accuracy.

Corrective Action Plan

At the end of the audit the depreciation schedule agreed with prior year schedules and continues to be maintained on a monthly basis to ensure accuracy of additions and deletions of assets.

**HIDDEN VALLEY LAKE COMMUNITY SERVICES DISTRICT
MANAGEMENT REPORT
CURRENT YEAR COMMENTS - FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2008**

08-FS-04 CROSS TRAINING

Condition

During our audit we noted that the District is working at cross training staff involved in the actual accounting for the District. However, the general ledger accounting function is predominantly handled by one person.

Cause

The District has limited staff and has not completed a cross training program.

Criteria

Good internal control as well as prudent management requires that a regular program of cross training is in place to ensure continuity of accounting services.

Effect of Condition

The District is not in a position to ensure continuity of accounting services without a program of cross training.

Recommendation

We recommend that the District continue a program of cross training.

Corrective Action Plan

The District will continue cross training employees to comply with checks and balances for internal control purposes. Currently there is no one person in full control of all facets of a job duty.

08-FS-05 FUND EQUITY RESERVES

Condition

At the time of our fieldwork, we noted that a reserve for connection fees had not been recorded in fund equity.

Cause

The connection fees had not been properly reserved when received.

Criteria

Generally accepted accounting principles require that revenues received that are legally restricted to be used only for specific purposes are to be reflected as reserved in fund equity.

Effect of Condition

The District financial records did not reflect a reserve for connection fees at June 30, 2007.

Recommendation

We recommend that the District establish a reserve for connection fees.

Corrective Action Plan

The District has established a new fund to record transactions associated with connection fees.

**HIDDEN VALLEY LAKE COMMUNITY SERVICES DISTRICT
MANAGEMENT REPORT
STATUS OF PRIOR YEAR FINDINGS - FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2008**

<u>Audit Reference</u>	<u>Status of Prior Year Audit Finding</u>
07-01	STATEMENT ON AUDITING STANDARDS NO. 112 Recommendation We recommend that the District take all steps necessary to ensure that staff is in compliance with Statement on Auditing Standards No. 112 requirements. Status Not Implemented
07-02	CROSS TRAINING Recommendation We recommend that the District continue a program of cross training. Status Partially Implemented
07-03	FUND EQUITY RESERVES Recommendation We recommend that the District establish a reserve for connection fees. Status Not Implemented

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